MISSOURI BUDGET AND LEGISLATIVE AGENDA

Leading Missouri Through Tough Economic Times

"Like the people of Missouri, state government must live within its means. Missouri has been a leader in taking the fiscally responsible actions necessary to keep our state's budget balanced during these tough times."

Governor Bob Holden

Governor Holden continues to lead the state of Missouri through tough economic times. When Governor Holden took office three years ago, the state was beginning the largest fiscal challenge since World War II. Governor Holden faced these challenges immediately. His first task after taking office was to put Missouri's fiscal house in order. The Governor continues to make balancing the state's budget a priority. These challenges continue in Fiscal Year 2005 requiring additional budget cuts. Through his legislative and budget agenda, Governor Holden again presents a balanced Fiscal Year 2005 budget. His approach focuses on protecting education, promoting job growth, and protecting the health and safety of Missouri citizens.

ENSURING FISCAL RESPONSIBILITY

Missouri is one of only seven states that continues to receive the highest AAA rating from the three national rating agencies. In his first three years, the Governor has taken the following steps to address the state's declining revenue situation and ensure that the state's budget remains balanced:

- Cut $1.2 billion and 2,000 positions from state department budgets – the most in Missouri history. The cuts recommended by the Governor in Fiscal Year 2005 will bring the total number of positions reduced to 3,000.

- Offered a time-limited tax amnesty program to businesses and individuals that voluntarily agreed to settle past debts. This successful program generated $70 million in revenue.

- Held budget summits with citizens, legislative leaders, and business leaders across the state. These sessions generated input aimed at increasing government efficiency and making sure working families and small businesses do not carry an unfair share of the state tax burden.

- Conducted a review of corporate tax loopholes and identified those that take much needed revenue away from the state without providing a benefit to the economy.

- Reorganized key operations of state government. In the past three years, the Governor has consolidated motor carrier services and highway safety programs in the Department of Transportation, workforce development services in the Department of Economic Development, and family support programs in the Department of Social Services. He also eliminated two divisions of state government and created a Children's Division in the Department of Social Services to focus on children in state custody and those at risk of abuse or neglect. Governor Holden has been reviewing the structure of state government since he took office. He is committed to integrating departmental operations to improve the way the state delivers services. These efforts have saved over $4.5 million and reduced the state workforce by about 160 positions.

- Proposed a retirement incentive plan for state employees that was enacted by the General Assembly. The plan decreased the number of employees, reduced personnel costs, and allowed departments to reorganize their workforce. Savings will be $18.2 million and 557 positions will be eliminated from the state budget.

- Reduced rental costs for state offices by consolidating programs within existing state-owned or leased buildings and decreasing the amount of office space rented by the state. Savings are projected to be over $1 million annually.

- Created a property preservation fund authorized by Senate Bill 243 (2003), allowing the state to assume liability for property damages. This initiative will save the state approximately $1 million annually in insurance costs.

- Reduced utility bills through energy conservation in state buildings, saving approximately $465,000 annually.

- Cut the state vehicle fleet by 20 percent.

Fiscal Year 2005 Budget Challenges

Nearly every state across the country has faced a fiscal crisis as a result of the downturn in the national economy. In November 2003, the National Governors' Association reported that even though "the national economy has now begun to recover, state revenue growth has not yet responded." This was confirmed by the National Association of State Budget Officers in a report issued the following month. State finances remain fragile. While some states are witnessing small increases in revenues, "most states have not seen any major rebound." In Missouri, there are signs the economy is slowly turning around. A modest rebound is expected over the next fiscal year.

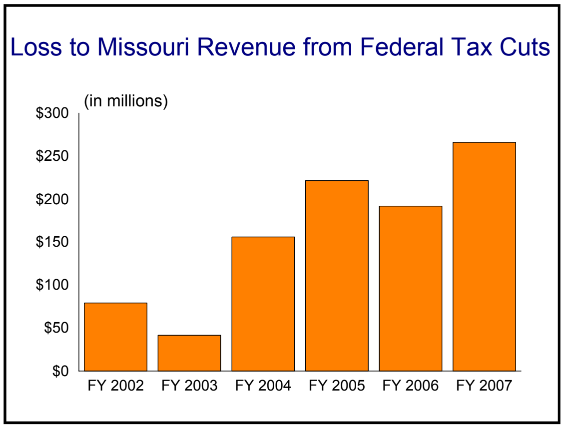
Even if economic recovery is on the horizon, the state budget picture remains guarded. As demonstrated by the following graphs, the increasingly tight budget is due to a combination of factors, including:

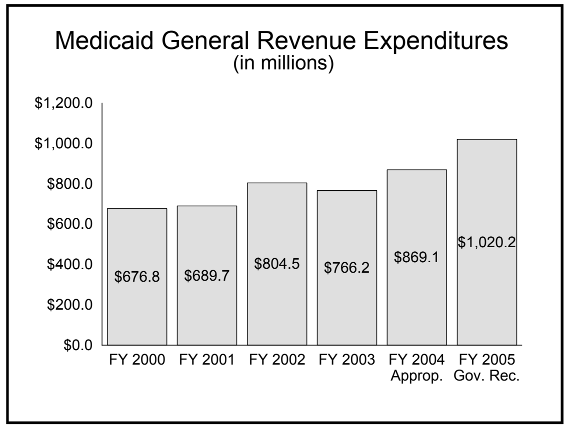
- Declining sales, corporate, and individual tax revenues coming into the state, primarily due to the recent recession.

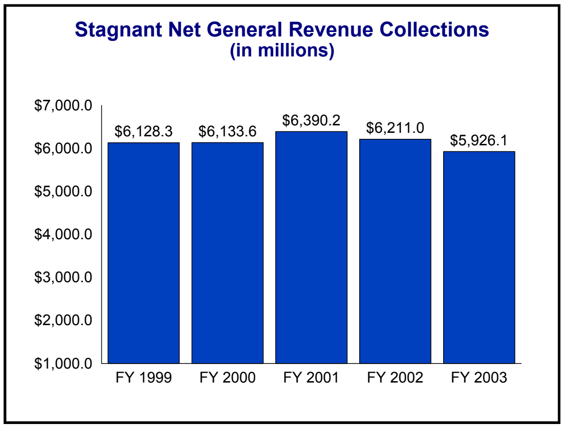
- Substantial increases in medical costs in the Medicaid Program.

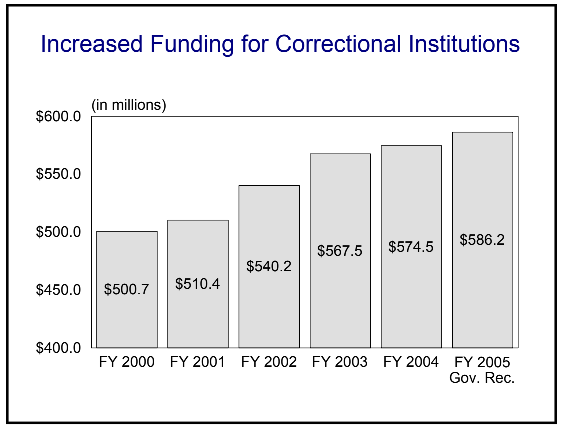
- Growth in the prison population.

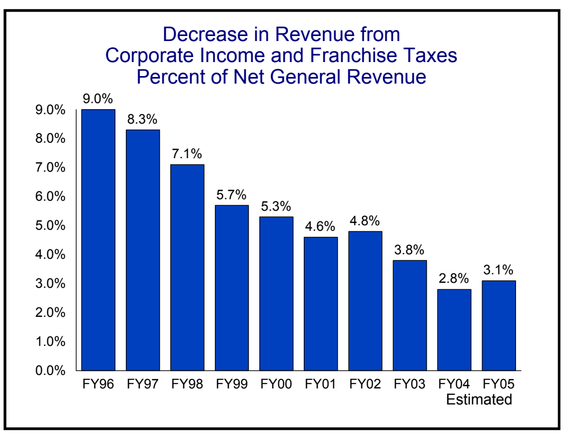
- An eroded tax base due to the negative impacts of federal tax reductions, corporate tax loopholes, and the escalating costs of state tax credits passed in previous years.

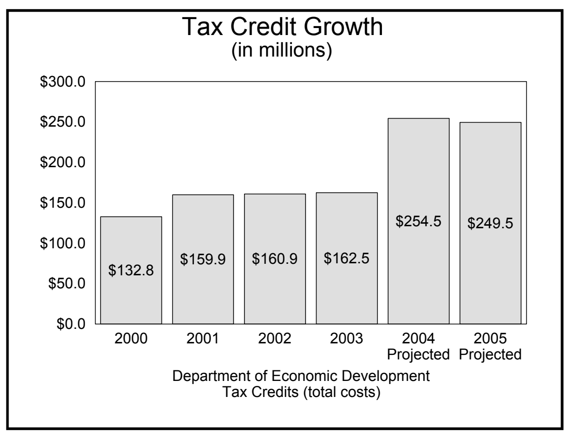

Loss to Missouri Revenue from Federal Tax Cuts
(in millions)
$300
$250
$200
$150
$100
$50
$0
FY 2002
FY 2003
FY 2004
FY 2005
FY 2006
FY 2007


Medicaid General Revenue Expenditures
(in millions)
$1,200.0
$1,000.0
$800.0
$600.0
$400.0
$200.0
$0.0
$676.8
$689.7
$804.5
$766.2
$869.1
$1,020.2
FY 2000
FY 2001
FY 2002
FY 2003
FY 2004 Approp.
FY 2005 Gov. Rec.


Stagnant Net General Revenue Collections
(in millions)
$7,000.0
$6,000.0
$5,000.0
$4,000.0
$3,000.0
$2,000.0
$1,000.0
$6,128.3
$6,133.6
$6,390.2
$6,211.0
$5,926.1
FY 1999
FY 2000
FY 2001
FY 2002
FY 2003


Increased Funding for Correctional Institutions
(in millions)
$600.0
$550.0
$500.0
$450.0
$400.0
$500.7
$510.4
$540.2
$567.5
$574.5
$586.2
FY 2000
FY 2001
FY 2002
FY 2003
FY 2004
FY 2005 Gov. Rec.


Decrease in Revenue from
Corporate Income and Franchise Taxes
Percent of Net General Revenue
9.0%
8.0%
7.0%
6.0%
5.0%
4.0%
3.0%
2.0%
1.0%
0.0%
9.0%
8.3%
7.1%
5.7%
5.3%
4.6%
4.8%
3.8%
2.8%
3.1%
FY96
FY97
FY98
FY99
FY00
FY01
FY02
FY03
FY04
FY05 Estimated


Tax Credit Growth
(in millions)
$300.0
$250.0
$200.0
$150.0
$100.0
$50.0
$0.0
$132.8
$159.9
$160.9
$162.5
$254.5
$249.5
2000
2001
2002
2003
2004 Projected
2005 Projected
Department of Economic Development
Tax Credits (total costs)

Problems with Missouri's Revenue System

Missouri's tax system has experienced many problems in recent years. These problems need to be permanently addressed or schools, seniors, children, and others who depend upon state services will continue to see services erode. The problems with Missouri's revenue system include a shortfall in revenue collections, holes in the tax structure, significant control over revenue by politicians in Washington, and a continued reliance on one-time revenue. More specifically:

Missouri has Experienced a Shortfall in Revenue Collections

- In Fiscal Year 2002, Missouri experienced the first decline in net general revenue collections since 1955, ending with 2.8 percent ($178.9 million) less in net general revenue collections than the year before.

- Fiscal Year 2003 brought the second year in a row of declining revenue, with a decrease of 4.6 percent ($284.6 million) in net general revenue collections.

- Declining revenue has occurred despite growth in personal income. Missouri is very dependent on the individual income tax as it makes up about 60 percent of net revenue. Therefore, collections should be closely tied to personal income.

- Individual income taxes, net of refunds, fell by $382 million between Fiscal Years 2001 and 2003, a ten percent reduction.

- Net corporate and franchise taxes fell by about $100 million from Fiscal Year 2000 to Fiscal Year 2003, a 30 percent reduction.

Missouri's Tax Structure is Full of Holes

- *Governing* magazine gave Missouri its highest ranking (four stars) for its fiscal management. Missouri was one of only six states to receive four stars.

- At the same time, *Governing* gave Missouri only two stars (out of four possible) for the fairness of its tax system to taxpayers and the adequacy of its revenue. *Governing* said Missouri's "tax base is narrow and full of holes created by exemptions for both income and sales taxes. Fairness problems are inevitable when credits and exemptions expand without much review." Further, *Governing* said, "Given a system like that, it's no surprise that private-sector groups bring tax cases to court on a regular basis. There's relatively little to lose and a lot to gain."

- From 1997 to 1999, the General Assembly permanently reduced Missouri's tax base by about $700 million. The biggest reductions were the sales tax exemption for food, an increase in the personal exemption for individual income tax, and an exemption of private pensions from income tax. These tax changes have left a permanent and sizable hole in the state's revenue base.

- In addition to tax cuts, the General Assembly also expanded tax credits. Tax credits grew from $91 million to $163 million (a 79 percent increase) from Fiscal Year 1999 to Fiscal Year 2003. There are also significant amounts of tax credits that have been issued, but not yet redeemed. These tax credits could be redeemed at any time, causing budget uncertainties and placing further strain on revenue collections.

- Dr. Donald Phares completed a study titled Examining Missouri's Tax System: Tax Expenditures – A First Step. In this study, Dr. Phares refers to the loopholes in our tax system as tax expenditures. He notes "… tax expenditures are seldom, if ever, subject to legislative or executive scrutiny.... While the normal budget process subjects spending to rigorous and very detailed scrutiny and review, such is not the case with scores of tax expenditures that cost Missouri hundreds of millions of dollars in lost revenue." Dr. Phares goes on to say, "The tax base for the state's two major revenue generators, general sales and individual income, has been eroded through these provisions. In addition and perhaps even more damning for the general sales tax, the definition or scope of its base has been narrowed to tangible items that are a shrinking proportion of consumer spending."

Missouri's Tax System is Controlled by Washington

- Missouri's income tax is coupled to the federal tax system. Although there is good reason for this - ease of tax preparation - it means that the revenue available for vital state sources can be negatively affected by changes to the federal tax code. Federal tax cuts enacted in 2001, 2002, and 2003 will reduce state revenues by an estimated $220 million in Fiscal Year 2005.

- Although it would be too burdensome for taxpayers to completely decouple Missouri's tax code from the federal system, a few minor changes, such as simply establishing a state standard deduction, would give the state much more control over its own resources without burdening taxpayers.

Missouri has Relied Heavily on One-Time Revenue Sources

- Missouri has used one-time funding sources to fund ongoing expenses. Much of the one-time shortfall was made up by a combination of growing collections, other one-time sources, and targeted cuts to the budget. However, in the current and upcoming fiscal year, the magnitude of the one-time problem has grown to the extent that significant cuts will be necessary if new revenue is not approved.

- In Fiscal Year 2003, about $435 million in one-time funding was used to support the ongoing budget. This included balances from several funds and one-time revenue from intergovernmental transfer payments and tobacco settlement payments.

- The Governor proposed making up for the loss of these one-time funds in Fiscal Year 2004 through a combination of budget cuts and targeted revenue increases. The General Assembly, however, was opposed to any significant revenue increase. In May, the federal government offered a one-time budget fix for states through increased federal payments. The final budget in Missouri contained a combination of cuts, the one-time federal fiscal relief, and other one-time fixes.

SUMMARY OF FEDERAL TAX CUTS ON MISSOURI REVENUES

	FY02	FY03	FY04	FY05	FY06
Cuts Passed in State FY 2001					
repeal of the estate tax	$0.0	($30.0)	($72.0)	($117.0)	($165.0)
all other	($21.1)	($11.6)	($8.6)	($29.3)	($26.8)
	($21.1)	**($41.6)**	**($80.6)**	**($146.3)**	**($191.8)**
Cuts Passed in State FY 2002 and FY 2003	($58.0)	$0.0	($75.3)	($75.3)	N/A
Total	**($79.1)**	**($41.6)**	**($155.9)**	**($221.6)**	**($191.8)**

The most significant components of the current one-time problem are:

Federal fiscal relief
The Fiscal Year 2004 budget includes about $387 million in one-time payments from the federal government.

Revenue bonds
During Fiscal Year 2003 and Fiscal Year 2004, the state used $150 million and $124.5 million respectively to help balance the budget.

Legislation
The General Assembly approved legislation that will generate an estimated $83 million in Fiscal Year 2004. Unfortunately, about $67.2 million of that amount is from one-time sources, such as sweeping balances out of various state funds.

Missouri - A Low-Tax State

In addition to being ranked one of the top managed states, Missouri continues to be a low-tax state. It is a “good deal” to live in Missouri and taxpayers get a “good deal” from their state government. Among all states, Missouri ranks 46th in state and local government expenditures per capita. For each dollar an average U.S. citizen pays in state taxes, the average Missouri citizen pays only 80 cents. Missouri state taxes are 20 percent below the U.S. average and among the lowest in the region. Missouri corporations pay less taxes per capita than any other state with a corporate tax. By any objective measure, Missouri is a low-tax state as the table below demonstrates.

State Rankings on Missouri Revenues and Expenditures (as compared with all 50 states)

Indicator	Rank
Revenues	
Total Revenue - State and Local (Per Capita)	45
Corporate Income Tax - State (Per Capita)*	46
Total Taxes (Per Capita)	44
Expenditures	
Total Spending - State and Local (% of Personal Income)	45
Total Spending - State and Local (Per Capita)	46
Total State Government Expenditures (Per Capita)	43

Source: U.S. Census Bureau, State and Local Government Finances, 2003.

*Four states do not levy a corporate income tax.

CREATING A MORE EFFICIENT GOVERNMENT

Between Fiscal Years 2001 and 2004, over 2,000 positions have been permanently cut from the Missouri budget. The Governor's budget recommendations for Fiscal Year 2005 include a net reduction of an additional 1,000 positions, bringing the total reduction to about 3,000 positions.

Comparing 2003 to 2002 year-to-date employment information, Missouri had the sixth largest percentage **decrease** in state and local government employees of all states. Only Oregon, Michigan, Connecticut, Massachusetts, and West Virginia had bigger percentage reductions. All other states had smaller reductions or actually had growth in government employment.

When comparing Missouri to 12 other comparable states (13 including Missouri), Missouri ranks third from the bottom in the number of administrative employees per 10,000 people.

Streamlining Government

Although Missouri has already made deep administrative cuts and improved the efficiency of government operations, Governor Holden continues to encourage all state agencies to look for additional ways to save taxpayer dollars. Under the Governor's leadership, the following additional efficiencies will be implemented:

Spend Management

The Office of Administration has negotiated a contract with a firm that specializes in reducing procurement spending. The contract guarantees savings of at least twice the cost of the services provided, and the contractor projects annual savings between $6 and $9 million, all funds, in the first year. Additional savings are expected in future years. The effort is two-pronged – make sure the state is getting the best price possible and buy only what is actually needed. This effort will allow departments to more effectively operate despite large cuts in their current year budgets.

Responsible Debt Management

The state of Missouri is one of only seven states in the nation that have received the highest, "Triple A", bond rating from Moody's Investors Service, Standard and Poor's Corporation, and Fitch Ratings. Maintaining a high rating is important because it saves taxpayers' money. The Office of Administration keeps borrowing costs as low as possible by refinancing debt when market conditions warrant, saving over $69 million the last two fiscal years. To further maximize savings, the Governor recommends $200,000 in Fiscal Year 2005 to implement a debt management program. These funds will allow the use of outside consultants to monitor the state's debt and act quickly to save money.

Telecommunications Savings

Representatives from private business joined with several state agencies to lower telecommunication costs. Team recommendations include developing audit guidelines, factoring telecommunication costs into state leased facilities, and amending purchasing contracts. The estimated cost savings over the next several years could be more than $3 million, all funds.

Vehicle Fleet Management

Following the directive of Governor Holden, the state has reduced its passenger vehicle fleet by 960 vehicles since 2002, a reduction of nearly 20 percent. A new initiative will work to reduce 25 percent of vehicles traveling less than 5,000 miles per year. The vast majority of these vehicles are special function vehicles such as mail delivery and facility support vehicles.

Information Technology Consolidation

Efforts continue to effectively manage the state's information technology (IT). An interagency review committee has recommended the state move to a single e-mail system, and the Governor has directed the implementation of this recommendation. Savings will be generated by using the state's purchasing power to get the best deal on hardware and software and by only training employees to use one system. Staff now working on maintaining these multiple systems can be redirected to other critical needs. Savings will be redirected toward reengineering and consolidating business processes to eliminate duplicate systems and improving the state's IT infrastructure to take advantage of cost-saving mergers. Other IT operations being evaluated for future consolidation include servers, network management, and PC administration and support.

Medicaid Cost Containment

Missouri has undertaken numerous initiatives to control the costs of its Medicaid Program. Cost control measures have saved over $300 million, state and federal funds, in the Pharmacy Program alone. Because of rising health care costs and the crisis Missouri is currently experiencing with stagnant revenues, the Governor's budget includes numerous cost containment measures to curtail escalating Medicaid expenditures. Combined, these efforts will save about $52 million general revenue in Fiscal Year 2005. Savings will increase in future years. Cost containment efforts include: carrying out the final steps of a preferred drug list; expanding disease management and case management efforts; implementing copayments on some services; reducing rates paid to providers so they do not exceed normal Medicaid rates; improving the efficiency of the Non-Emergency Medical Transportation Program; and implementing several efforts to ensure Medicaid does not pay for costs that should be paid by private insurers.

Managing for Results Initiative

Governor Holden's Managing for Results Initiative (MRI) is a long-term commitment to doing business more efficiently and effectively. MRI is a management tool for the Governor and his cabinet to help keep government focused on results and to achieve meaningful improvements for citizens. MRI encourages fact-based decision making and innovation and recognizes the need for agencies to work together to obtain significant improvements. Agency projects have saved millions of dollars and countless hours for Missouri citizens and state employees. These projects have helped agencies cope with significant cuts in their salary and expense budgets. Descriptions of these projects can be found at the MRI website (www.mri.missouri.gov). See the following table for examples of recent MRI projects.

Managing for Results Initiative Project Results

Project	Problem / Issue Addressed	Benefits / Savings
Department of Social Services Child Support Enforcement Team	Child support collections were not reaching the children and families who depend upon them on a timely basis.	• 50 percent reduction in undistributed collections.
Department of Corrections Victim Services Team	Victims were not always being notified about upcoming parole hearings in a timely fashion.	• 100 percent success in providing 30-day advance notification of hearings.
Department of Corrections Population Growth Team	Offender population has been expanding rapidly. Left unchecked, new prisons will have to be built at a significant cost to taxpayers.	• Through improved Probation and Parole supervision, reduced incarcerated offender population growth from 4.56 offenders per day in Fiscal Year 2002 to 1.39 offenders per day in Fiscal Year 2003.
Department of Corrections Recycling Team	Recycling was not being done in all correctional facilities.	• $100,000 in savings at correctional institutions. • Efforts are being expanded to other institutions and other departments. • Savings are expected to reach over $1 million.
Department of Labor and Industrial Relations Appeals Team	Unemployment compensation appeals were taking too long to resolve.	• Backlog was reduced from a high of 6,800 cases to just 200. • The backlog should be eliminated in 2004.
Office of Administration Statewide Mail Services Team	The cost of mail is increasing at the same time agency budgets are being cut.	• $1.9 million in savings by implementing the use of computer technology and revising the mail services contract.
Department of Mental Health Collections Team	Many payments for services provided to individuals served by the department went uncollected.	• $534,498 in increased collections in Fiscal Year 2003. • When fully implemented, collections should increase to over $2 million annually.
Office of Administration Statewide Telecommunications Team	The budget for telecommunications services is $35 million annually statewide. Opportunities to improve operations could have a significant positive impact on the state budget.	• Developing audit guidelines, incorporating costs into state space plans, and amending purchasing contracts will save a projected $3 million over the next several years.

THE IMPACT OF STATE BUDGET CUTS

The General Assembly has already made deep cuts to the Missouri budget. Examples of cuts already made include:

- The School Foundation Program was reduced by $115.8 million by the General Assembly. Since a significant percentage of the program supports teacher salaries, school districts were forced to eliminate 2,001 classroom teachers and aides. An additional 508 positions were also reduced that included principals, supervisors, library/ media personnel, guidance personnel, and administrative staff.

- Reductions to the School Foundation Program have forced school districts to increase class sizes and eliminate programs for gifted, at-risk, and disruptive students.

- New technology grants to schools were reduced by $8.8 million, a 42 percent decrease. This resulted in markedly reduced grants to school districts for the purchase of computers, software, and Internet connections.

- A reduction of $39.7 million in state aid to higher education institutions has resulted in tuition costs at Missouri's public four-year colleges and universities rising by an average of 14.8 percent in the last year. Tuition costs at Missouri's community colleges have risen by an average of 9.3 percent over the same time period. The average Missouri college student now pays $1,344 more per year in higher tuition and fees to attend a four-year institution and $342 more per year to attend a two-year institution. The tuition increases have placed an enormous financial burden on Missouri students and their families, and have forced an increasing number of students to take on unacceptably high levels of debt in order to pursue a college education. In addition to increasing tuition, institutions have been forced to eliminate programs and cut faculty and staff in order to deal with the funding reductions.

- Missouri's grant and scholarship programs were reduced by $589,550, resulting in many students not receiving financial aid. Reduced financial aid, on top of crippling increases in tuition, is prohibiting some lower and middle income families from affording the cost of college.

- $75 million state and federal funds cut from Medicaid resulted in approximately 34,300 Missourians losing health care. This reduction eliminated health care coverage for parents trying to transition from welfare to work and reduced coverage for pregnant women. With the loss of access to preventative care, it is likely that many have ended up in emergency rooms and hospitals with more expensive health care needs.

- $10.3 million cut from the Grandparents as Foster Parents Program. Eligible participants have had their reimbursement rate reduced from $202 to just $68 per month for the 2,500 children served by the program. This has created a financial burden for grandparents who have accepted the responsibility of raising their grandchildren on a fixed income.

- $10.3 million in reductions to psychiatric community programs for over 4,000 seriously mentally ill and emotionally disordered children and adults. Services reduced include outpatient treatment, residential treatment, case management, recovery support, and crisis intervention.

- $7.2 million in cuts to community programs for 2,000 persons with disabilities, resulting in reductions for day habilitation, respite care, transportation, and services to autistic clients.

- $3.8 million in reductions to substance abuse treatment services, resulting in more than 1,300 clients no longer having access to services. These include services such as Oxford Houses and Comprehensive Substance Treatment and Rehabilitation (CSTAR) programs that serve pregnant women and women with children.

- $3.1 million cut from environmental health and communicable disease prevention efforts. These reductions occurred while new and increased demands are developing to address West Nile disease; Severe Acute Respiratory Syndrome (SARS); anthrax; and soil, water, and air contamination.

- $3.6 million for women's primary health care services was eliminated. This program served over 30,000 low-income women throughout the state. Consequences of not funding this program include undiagnosed venereal diseases and cancer, inadequate prenatal care, low-birth weight babies with complex short-term and long-term health problems, and higher infant mortality.

- $2.6 million was cut from the Department of Corrections, resulting in the elimination of 88 institutional staff positions including cooks, caseworkers, teachers, chaplains, and maintenance staff. These reductions put greater strains on the correctional officers who supervise inmates as more of their efforts must be directed to covering the duties of the eliminated positions.

- $6.2 million was cut from the Customized Job Training program. This has resulted in fewer companies receiving assistance, and smaller awards for those that do. Employees receiving training decreased from 35,613 to 24,639 which translates into a less competitive workforce and fewer high-paying jobs.

- $1.1 million in technology funding cuts have resulted in the elimination of the centers for Advanced Technology and Electronic Materials Applied Research Center programs. The Manufacturing Extension Partnership Program and Innovation Centers have also received less funding. These combined actions mean fewer research projects and fewer companies that are served with technology and commercialization activities. This will have a negative impact on the amount of new investment and sales generated by companies that use these programs.

- $180,688 was cut and forced the closure of the Cameron Veterinary Laboratory. This facility handled the laboratory component of the State Meat and Poultry Inspection Program and provided diagnostic testing for animal diseases in northwest Missouri.

- $4.6 million in assistance for transit providers has been reduced, eliminating approximately 1.3 million trips. Many people rely on public transportation to get to work, get to medical appointments, and carry out other daily activities.

- $4 million for Landmark Local Park grants has been eliminated. This program provided an essential source of revenue for developing park and recreation facilities throughout the state.

- State employees have been cut significantly, particularly general revenue funded staff. For example, from Fiscal Year 2001 through 2004:

  - The Department of Economic Development lost 48 percent of its general revenue staff.
  - The Office of Administration lost 25 percent.
  - The Department of Public Safety lost 18 percent.
  - The Department of Health and Senior Services lost 16 percent.
  - The Department of Mental Health lost 8 percent.

These cuts have led to reduced services for Missourians and increasing workloads for remaining employees.